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October 3, 2000

**Washington Mutual**

Manager, Dissemination Branch
Information Management and Services Division
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention 1550-0023
public.info@ots.treas.gov



Dear Office of Thrift Supervision:

Washington Mutual, Inc. ("Washington Mutual") is pleased to respond to the Proposed Agency Information Collection Activities (the "Proposal") notice and request for comment as published in the August 4, 2000 *Federal Register* by the Office of Thrift Supervision (the "OTS").

Washington Mutual is a financial services company serving consumers and small to mid-sized businesses. Although we operate principally in California, Washington, Oregon, Florida, Texas and Utah, our operations serve consumers in all 50 states. Through our subsidiaries, we engage in mortgage banking, consumer banking, commercial banking, financial services and consumer finance. Two of our banking subsidiaries, Washington Mutual Bank, FA and Washington Mutual Bank fsb, would be subject to the revisions of the Thrift Financial Report ("TFR") as stated in the proposal.

To make the content of the TFR more relevant in today's evolving financial services environment, Washington Mutual generally supports the proposed revisions. Washington Mutual also, however, generally agrees with the commentary made in the Financial Institutions Accounting Committee ("FIAC") letter to you dated October 2, 2000.

Washington Mutual would like to provide specific comments on the proposed definition of subprime loans. For the reasons discussed in this comment letter, we urge that any definition of subprime loan be prospective only and that the definition more specifically defines applicable borrower characteristics and other appropriate considerations.

The OTS indicates that the borrower's characteristics should determine whether a loan is subprime. For purposes of reporting information on these loans in the TFR: "[S]ubprime loans are extensions of credit to borrowers who, at the time of the loan's origination, exhibit characteristics indicating a significantly higher risk of default than traditional bank lending customers." We commend the OTS for focusing on the borrower in their proposed definition of subprime loans. We respectfully suggest, however, for operational and confidentiality reasons, that the definition should be only applied to loans made in the future if the definition depends on the characteristics of the borrower. Information about the borrower's income at the time of loan origination, for example, is not usually maintained in the computerized records of loans that are used for financial reporting purposes. The necessary data fields presently are not in most systems. Extensive

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reprogramming would be necessary to make the information accessible for financial reporting purposes. Such accessibility of specific borrower-related information, however, would heighten the risk of inadvertent disclosure of such confidential information. For these reasons, we recommend a prospective definition, so that a simple "Prime/Subprime" data field can be added to the loan records that are accessible for financial reporting purposes.

We suggest that, in formulating the definition that is to be applied prospectively, the OTS should focus on, and define more specifically, the differences between traditional and "higher risk" borrowers. "Higher risk" borrowers could be defined as borrowers whose credit report or loan application reveals a major derogatory event within the five years prior to the application or reveals two or more payments in excess of 60 days past due in the twenty four months prior to the application. Collections under $200 should not be considered in this evaluation, while rolling delinquencies should be treated as one occurrence. "Major derogatory events" include judgements, charge offs, repossessions, bankruptcies, foreclosures, or deed in lieu of foreclosures.

In determining whether to charge subprime rates, however, some lenders disregard major derogatory events that resulted from medical conditions. These lenders may make loans on "prime" terms to such unfortunate borrowers, whereas other lenders may make loans to them only on subprime terms. A definition based solely on the borrowers' characteristics would treat all loans to such borrowers as either prime or subprime, regardless of interest rates. Therefore, any definition should allow consideration of other factors in addition to borrower characteristics.

The OTS specifically asked whether interest rates or fees could be used to identify subprime loans. The interest rate or fee on a "subprime" loan is often higher than the interest rate or fee on a comparable loan made to an applicant without credit blemishes on the date of loan origination. As market interest rates change, however, prime loans on one date of origination may have terms that are hard to distinguish from the terms of subprime loans on another date of origination. Neither loan files nor the loan servicing system, however, currently contain data on interest rates or fees charged to other borrowers on the date of origination. Therefore, any definition of subprime loans based on interest rate or fee differentials must be prospective only.

Furthermore, definitions based on interest rates alone will be underinclusive. Different lenders can adapt to borrowers' credit blemishes in a wide variety of ways. Subprime borrowers may pay prime rates but high fees. Subprime borrowers may pay prime rates and prime fees but have a high loan to value ratio. Yet a high loan to value ratio, by itself, should not be regarded as an indicator of subprime lending if the borrower pays prime rates and fees. A definition may need to reflect both the borrower's characteristics and the terms of the loan in order to be accurate.

Whatever the final definition is, it should be applied on a prospective basis only to allow for development of information necessary for compliance. As noted above, the detailed information with regard to borrower characteristics and loan terms in comparison with other loans on the same date of origination are not in the records that are accessible for financial reporting purposes. Addition of a "Prime/Subprime" data field would require substantial amounts of time and expenditures of resources in a computerized loan origination system. To avoid the need for an expensive concentration of scarce programming resources on implementation of the new definition, the OTS should conclusively establish the definition a substantial period of time prior to the date on which the definition is used to categorize loans.

The OTS also invited comments as to the practical utility of a possible addition of information about associations' interest rate risk limits for a plus/minus 200 basis point rate shock scenario. Although the Proposal itself does not specify that these limits will be expressed in terms of net portfolio values ("NPV"), other OTS directives have established a method of measuring the effect of instantaneous rate shocks on NPV ratios. Washington Mutual respectfully suggests that this method is flawed, results in overstatement of the extent of interest rate risk, and should not be reinforced by incorporation into the TFR. NPV ratios that are determined from instantaneous rate shocks simply do not reflect accurately dynamic balance sheet processes. Furthermore, large instantaneous shocks are theoretical and do not occur in actuality. Typically, interest rates move upward or downward in small increments. While the total amount of movement can be substantial, institutions usually can implement balance sheet management strategies during such episodes to reduce the consequences of changing rates. Rather than mandating arbitrary and unrealistic NPV ratio tests, we recommend that the OTS develop tests that reflect likely market dynamics in a more realistic manner. In addition, for institutions that have developed rigorous internal models and interest rate risk management procedures, the OTS should not impose the NPV ratio tests. Rather, the OTS should require such institutions to develop appropriate interest rate risk measures and limits and then review the adequacy of these measures, the appropriateness of the limits and the overall effectiveness of interest rate risk management through the examination process.

Washington Mutual appreciates this opportunity to comment on the proposal set forth in the notice and request for comment. We would be pleased to discuss further any questions that the OTS may have with respect to our comments and recommendations.

Sincerely,

Richard M. Levy
Senior Vice President and Controller